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Monthly Letter on Economic Conditions Government Finance

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General Business Conditions

THE business recession which people have talked about so much and so long is still slow to develop. Shortening of commitments, now that long forward buying for protective purposes is no longer so essential, has been reflected in slackening orders in a good many lines. Likewise shifts in demand mean less business for some, although more for others. But these and other adjustments, of the kind that were to be expected as shortages and sellers' markets gave way to normal competitive conditions, have not proved depressing in an overall sense. They have proceeded thus far with only minor effects on production and employment, and therefore on income payments, buying power and the volume of trade. Moreover, there are no convincing signs that the decline is snowballing or accelerating, even though mass plant vacations and loss of coal production through the ill-advised miners' walkout may combine to cause a Summer dip.

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In many important lines unfilled orders are still rising. Even in textiles and women's apparel, which have often been described as weak spots and in which the production trend has been downward, recent weeks have brought improvement. Sentiment in apparel trades is heartened by the good impression the new Fall lines have made, through style changes and better workmanship and materials. Initial buying has been careful, in harmony with the policy of minimizing risks. But the manufacturers are back at work, and the better retailers, if not all, have pretty well cleared out old stocks to be ready for the new lines. Now the question is how the public will receive them. For some time retail trade reports have been good. Department store sales in May, according to the Federal Reserve Board's seasonally adjusted index, equalled the previous peacetime record, and the early June figures were on about the same level.

In the primary goods markets there may be question as to how long the improvement will hold, and the situation in the heavier cotton goods is easy. Nevertheless, many branches of the textile industry have well-filled order books. All this has an obvious bearing on the rate and timing of business recession, and on the general outlook for the second half-year.

Many Industries Still Under Pressure

Among steel people most opinion, taking account of present backlogs and orders, continuing shortages and export demands that cannot be filled, is that operations will hold close to an all-out basis during the remainder of the year. "Iron Age" expects no substantial drop in steel ingot output before the first quarter of 1948, if then. Probably even more positive assurance can be felt that the automobile industry will continue to sell all the cars it can make, although the present premiums of about $500 on resales of low mileage Chevrolets, Fords and Plymouths may diminish as the Summer goes on.

The petroleum industry is under such pressure that supplies of gasoline are being allocated among dealers in the Middle West, and there is concern that fuel oil stocks cannot be built up during the Summer to meet the Winter demand. Many machinery and equipment manufacturers have continued to add to backlogs, according to their latest figures. The construction industry may slump less than people fear, for restrictions on non-residential building, except amusements, expired June 30. A large volume of prospective contracts is dammed up behind these restrictions. How much will be released is a guess, but Housing Expediter Creedon, adding up reports from his field staff, has put the figure as high as $2 billion. Rent controls on new construction have also ended.

It would be something new to have a business recession reach substantial proportions while steel, automobiles and many other heavy industries have markets for all they can produce. In their sustained activity, along with record-breaking farm income, is found the principal explanation for the good volume of retail trade. The employment they give and the income they generate maintains purchasing power, which flows around the circle.

Sources of Purchasing Power

The question which confronts business men who are trying to plan ahead is whether this flow of purchasing power around the circle will be breached, and if so, when and to what extent. Purchasing power is derived basically from production. Production may be checked because supply overtakes requirements in specific lines — as now in tires, for example — either because consumption of the particular product has natural limits or because the price is too high and too rigid, or a combination of both. Fear that this condition is developing in more and more lines is perhaps the most common reason advanced for expecting a considerable recession.

Some of the production which has been creating current purchasing power has gone into inventory. Some has gone into export. Under the short-term buying policies which are now so widespread, inventory accumulation seems unlikely to go much further, and when it ceases the markets must absorb a correspondingly increased volume of goods or production must be reduced. Likewise if the export surplus declines below the recent rate, as is commonly predicted, that much more will be available for the home markets. Finally, the Federal Government is taking money out of the income stream instead of putting it in, now that the budget position has changed from deficit to surplus.

Forebodings about the future based on analysis such as the foregoing are shared by many people. They foresee shrinkage in production and the flow of income for one or more of these reasons. The basic question, however, is whether new demands will come forward to replace any decline from the sources mentioned. One factor which should give encouragement is the evidence that in some lines shortages still exist and an active demand is still going unsatisfied. In these areas greater production is wanted. In the cases where materials and fabricated parts do not now cover every need, an easing in one quarter will permit greater output in another.

The Prospect

The general problem of maintaining demand divides in two parts. It is, first, to shift labor and resources from goods which are now coming into abundant supply to those that are still scarce. It is, second, to get more efficiency and lower cost production and distribution in order to establish prices which will expand markets. The specific problem for both management and labor is to find out what people will buy and what they can pay for it and find a way to produce it at the price.

Readjustments are required by shifts of demand from one product to another, as at present from soft goods to automobiles; from one manufacturer to another — for example, the present trend away from unfamiliar and unadvertised brands; and from one channel of distribution to another. Some old businesses get overexpanded, and among new people in business, some are naturally inexperienced or incompetent. The readjustments fall particularly on these, and failures and losses reappear in the news. The strongest reason for anticipating recession is the fact that shifts are difficult and are seldom accomplished with complete smoothness. The difficulties are compounded when adjustments are resisted, as when merchants put off taking their markdowns or when costs are held up by labor inefficiency and work stoppages.

On the other hand, the conditions cited in the heavy industries and the absence of financial strain provide strong supporting influences. The conservatism of buyers makes things harder for sellers who see their orders running down, but it helps preserve stability. On the whole, the present state of business, and the relatively good reports of recent weeks, suggest that recession is not coming as early as many had expected or moving as rapidly. The downward trend is staggered, and not concentrated; and early readjustments, which many interpret as recession, in fact tend to moderate the recession.

The Agricultural Situation

Recent developments require revision in earlier opinions as to the outlook for farm prices and farm income in the second half-year. Six months ago government experts were predicting that farm prices at the end of 1947 would be some 15 to 20 per cent lower than at the beginning of the year, and that farm income for the year would be 5 to 10 per cent below the record 1946 level. The public generally accepted these estimates. They looked for a drop in exports of American farm products with the ending of Lend-Lease and UNRRA and expected further recovery of European agriculture. Given another good growing season the reappearance of farm surpluses was a reasonable possibility.

Prices of farm products now, however, are 4 per cent higher than in January. During the six months it has developed that Western Europe will harvest even smaller crops than last year, that the rice shortage in the Far East will continue for another year, and that the export demand for U. S. grains and other foods in 1947-48 will be greater than ever. The consequence of these and other changes is that another large production this year will likely be marketed at firm prices with little, if any, decline in income. For the first five months of this year income from livestock has been 40 per cent higher than in the same period of 1946, from crops 10 per cent higher, and total income 30 per cent higher. These comparisons are distorted by the fact that price ceilings were in effect during the first half of 1946, and the gains must narrow sharply during the second half. Nevertheless, the phenomenal winter wheat crop is being marketed at high prices, an upsurge in meat prices has put meat again on the front pages of the newspapers, and it is plain that the estimates of last January should be revised upward.

The winter wheat harvest now is in full swing. The total wheat crop, both winter and spring, will be around 1,410,000,000 bushels, according to the latest Government estimate. This is some 22 per cent larger than last year's crop, which set the previous record. It is difficult to appreciate how large this crop is without comparisons. In the four states of Kansas, Texas, Oklahoma, and Nebraska the crop will be as large as the 10-year average winter wheat production for the whole country.

Considering foreign needs and our own inadequate reserves, drawn down by last season's exports, this record crop is a blessing from every viewpoint. The surplus available for export and carryover will be around 600,000,000 bushels, compared with actual exports during the past crop year of around 375,000,000. Tentative indications are that the goal will be to ship around 500,000,000 bushels and add around 100,000,000 to our low carryover, bringing it up to a normal level of 175,000,000 by July 1, 1948.

With a price floor set under wheat by the government loan of $2.08 Chicago, or $1.83 at the farm, the value of this year's crop to the farmer will be around $2,600,000,000 at the minimum, comfortably above the record farm value of the 1946 crop. So far, new crop wheat has been moving at 15-20c above the loan level.

Meat Prices Up

While the statement has been made that exports have driven meat prices up, the high price of meat is due mostly to a record domestic demand. Meat exports during the first half year were less than half those of a year ago and are expected to be even smaller hereafter; they are controlled by government allocations, which in the second quarter were about 3 per cent of expected total meat production for the period. Meat purchases by the armed forces are running about 30 per cent below a year ago. Supplies remaining for civilian consumption for the year are the largest for the 25 years for which records are available, and on a per capita basis are about 12 per cent above prewar. Beef production is at a new high. But demand has increased even more. Unless our own demand recedes, meat prices may be expected to stay high. The Department of Agriculture had urged farmers to raise close to 95 million pigs in 1947, but the estimated outturn of the Spring and Fall crops is 85.7 million, only 3 per cent larger than in 1946 and slightly below 1939. Thus the prospective pork supply appears short in relation to demand, and 1948 is expected to bring lower beef and lamb production.

A basic influence holding up meat prices is the prospect that the corn and other feed grain crops may be considerably smaller than for the past few years, due to the rains and floods which have reduced acreage and delayed planting. It is too early yet to write the corn crop off as a disaster, but too much of it will run a close race with early frosts. A larger carryover of corn into the new season will augment the supply, and help maintain livestock, dairy and poultry production, but price ratios between feeds and animal products are less favorable for feeding.

Farm purchasing power at or close to the peak will support business in the farm states at high levels. An offset is the fact that the food cost of living does not promise to come down to the extent expected. Moreover, farm readjustment is

deferred rather than escaped, for we cannot hope to keep on finding markets for record-breaking wheat crops and all the other products now going into export.

Foreign Aid and the Export Boom

The speech of Secretary of State Marshall at Harvard University June 5 has been widely acclaimed both here and abroad. Mr. Marshall expressed the view that the task of getting Europe back to work is properly "the business of the Europeans", and he described the role of this country as one of providing "friendly aid" in drafting a program and "later support of such a program so far as it may be practical for us to do so." The program, he went on to say, "should be a joint one, agreed to by a number, if not all European nations":

> It is already evident that, before the United States Government can proceed much further in its efforts to alleviate the situation and help start the European world on its way to recovery, there must be some agreement among the countries of Europe as to the requirements of the situation and the part those countries themselves will take in order to give proper effect to whatever action might be undertaken by this Government.

Secretary Marshall indicated that Europe would need to rely on foreign food and other essential products—principally from America—for three or four years "or face economic, social and political deterioration of a very grave character." Even apart from costly delays in peace settlements, European economic rehabilitation will require a much longer time and greater effort than had been anticipated because confidence in many of the local currencies has been "severely shaken" and because of the complete breakdown of the business structure during the war. The remedy, he affirmed,

> lies in breaking the vicious circle and restoring the confidence of the European people in the economic future of their own countries and of Europe as a whole. The manufacturer and the farmer throughout wide areas must be able and willing to exchange their products for currencies, the continuing value of which is not open to question.
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> Our policy is directed not against any country or doctrine but against hunger, poverty, desperation and chaos. Its purpose should be the revival of a working economy in the world so as to permit the emergence of political and social conditions in which free institutions can exist. Such assistance, I am convinced, must not be on a piecemeal basis as various crises develop. Any assistance that this Government may render in the future should provide a cure rather than a mere palliative.

Secretary Marshall ventured no estimates as to the amount of help that Europe might require; his emphasis was on what European countries could do to help themselves. Unfortunately public discussions have attached huge sums of money to his proposal and assumed it meant a great new program of gifts and loans. This has left on the public mind a blurred and confused impression of what the Marshall policy really is. For example, Benjamin V. Cohen, State Department adviser, speaking in California a week later, stated that Europe may need as much as $5 or 6 billion a year in outside assistance during the next four years. It should be emphasized that the Marshall plan has no such necessary implication.

The Task of Europe

A generally favorable reception of Secretary Marshall's view at home may be due to the fact that he has given official expression to thoughts that were latent in many American minds. We can understand that Europe needs help; we have not wished to be, and have not been, ungenerous; but we have been apprehensive lest our resources be squandered and our aid unproductive. Only the Europeans can make it productive.

The principle that the major responsibility for working out a sensible European economic program is for the Europeans themselves seems to be acceptable on all sides. Too much time has already been lost in solving the essential problem of restoring the coal production of the Ruhr Valley. The reviving intra-European trade must be encouraged. The will to work and the incentives to trade and enterprise must be strengthened, threats of confiscation removed, and printing press inflation brought to a halt where it is still going on. Otherwise American aid is largely wasted.

Risks to American Strength and Stability

A second principle of foreign assistance is that American aid must be within our resources. It must be within the limits of what we can spare in physical goods and it must not involve a dangerous risk of unstabilizing our own economy through price inflation or overtaxation. Mr. Baruch as early as November, 1945 suggested the necessity of surveying our resources, and determining how much and what we can export without jeopardizing our own strength and stability.

Former President Hoover, after examining the trends in our foreign trade and prices, has drawn the conclusion that we are now "overexporting" as a direct result of "our rate of giving and lending." In a letter to Chairman Bridges of the Senate Appropriations Committee June 15, he stated that, in light of the strong upward pressure on our price structure generated by export

demands, we "cannot continue at such a rate with our present production and consumption without further evil consequences to our stability." The "evil consequences" Mr. Hoover had in mind included not only the "dangerous spiral of increased costs of living and wages" but "the impairment of our natural resources" involved in the export of scarce materials, and tax burdens which run to about 35 per cent of our national income. "No free nation can continue (to tax) at that rate without impairing its productivity."

"The greatest danger to all civilization," Mr. Hoover said, "is for us to impair our economy by drains which cripple our own productivity. Unless this one remaining Gibraltar of economic strength is maintained, chaos will be inevitable over the whole world." The task of America is to stay strong.

Studies to Be Undertaken

Emphasis on these points by Mr. Hoover and others has been followed by Presidential appointment of three committees. One composed of Government specialists, headed by Secretary of the Interior Krug, will deal with the status of our natural resources; a second under the aegis of the President's Council of Economic Advisers will analyze the effects of foreign help on the American economy; and a third, composed of distinguished citizens drawn principally from business, labor organizations, agriculture, and the universities, and headed by Secretary of Commerce Harriman, will be called upon "to determine . . . the character and qualities of United States resources available for economic assistance to foreign countries" and to advise the President "on the limits within which the United States may safely and wisely plan to extend such assistance."

As the President indicated in announcing the appointments, the extent to which we should continue aiding foreign recovery is not easy to ascertain. The physical quantities that can be spared depend upon such varied and partly unpredictable factors as the size of our crops, the fluctuations in our industrial production and our own demands, and finally a determination of the extent to which European needs should take precedence even if reduction of our home consumption is involved. Foreigners themselves would do well to defer non-urgent demands until some of the pressure of domestic demands is off. Restraint is clearly called for, on both sides.

"Overexporting," "overgiving," and "overlending" reveal themselves in high and rising prices, in war-level taxes, and the resultant pinch on the American family budget.

The "Dollar Crisis"

The disparity between our exports and imports reached the widely publicized "billion a month" in March and again in May, after having narrowed somewhat in April. Reported merchandise exports in the first five months amounted to \$6.3 billion while imports came to only \$2.4 billion. Imports paid for a little less than 40 per cent of the goods shipped abroad. Around one-third was paid for indirectly by the American taxpayer, financed by the U. S. Treasury under one account or another. The remainder was paid for principally with gold or foreign dollar balances previously accumulated.

Observers abroad, from a study of the unexpected magnitude of the exports, have drawn the conclusion that foreign dollars and dollar credits are being used up so rapidly that a "dollar crisis" lies in the offing unless our loan program is expanded promptly. On this side of the Atlantic there is a feeling, shared by some business men, that the loan program must be kept going to keep our exports booming and our manufacturing capacity and labor force fully employed.

These viewpoints, expressed with good will and sincerity, nevertheless carry implications that cannot lightly be dismissed. For either Europeans or Americans to ask for a continuous flow of foreign aid, with no visible end in sight and no slackening in rate, comes close to confessing to the futility of the whole enterprise. If Europe is not already developing a basis of self-support, with our substantial aid, a dollar crisis is only postponed to a day when America wearies of the load.

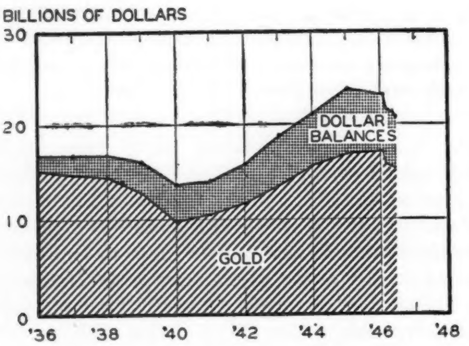
To look at the jobs "created" in producing for export, and to consider that giving away vast amounts of goods is essential to our "prosperity," is to see only one side of the picture. Money collected through taxes and used to pay for the exports could have supported just as many jobs if the taxpayer, instead of having to pay the tax, had his own free choice in disposing of his income. When the aid is not covered by a tax it involves that much pure inflation.

Foreign Gold and Dollar Resources

So far as money is concerned, enough dollars are already in the hands of foreign nations, or will become available under existing programs, to tax our export capacity for some time to come. How far the world is from a general shortage of dollars is brought out in the accompanying chart, which shows foreign-owned gold and dollars (exclusive of those contributed to the International Monetary Fund and the World Bank). The monthly figures for the first five months of 1947 are ap-

proximate estimates on the basis of known data on foreign trade, gold transactions, foreign lending, and fluctuations in foreign balances. Through January, the dollar balances are based on Treasury compilations published in the Federal Reserve Bulletins. The gold figures for prior years are consistent with estimates published from time to time by the Federal Reserve Board and the Bank for International Settlements.

Gold holdings outside the United States stock, and outside the Monetary Fund and the World Bank, are estimated at $15 billion at the end of May, even after the heavy transfers in February to get the Fund going. This compares with $10 billion in 1940. Dollar holdings of foreigners evidently amounted to more than $5 billion at the end of May. The total of gold and dollars is estimated at $20 to 21 billion. New gold production outside Russia may run to $700 million annually.



Estimated Foreign-owned Gold and Dollar Balances
Excludes holdings of the International Monetary Fund and International Bank. Figures plotted annually through 1946; monthly for first five months of 1947. The drop in February reflects gold payments to the Fund.

While a not inconsiderable part of the gold and dollar resources are held in "last ditch" monetary reserves, represent private holdings, or are tied up or committed in other ways, and while their potential buying power has been reduced by the rise in American prices, the unprecedentedly high levels at which they have been running provides an answer to the more extreme statements about a world-wide "dollar crisis."

Additional Dollars Available

Aside from the gold and dollars in foreign hands that can be used to buy American products, dollars are constantly being supplied under existing programs. Two of the biggest of the potential sources, the International Monetary Fund and the International Bank, have no more than begun their operations.

Mr. Hoover estimated the "unexpended balances of appropriations and various credit commitments to foreign nations" on July 1, 1947 at over $5 billion, to which should be added private loans and gifts of perhaps $1 billion in the next year and unknown further credits to be extended by the International Bank and Fund. The full potential of money so far unused under existing programs runs to at least $12 billion as indicated in the following table:

Potential Supply of Additional Dollars Under Existing Programs
(In Millions of Dollars)

	Available or potentially available	Funds drawn through June 1947	Unutilized
U. S. Government Lending			
Export-Import Bank loans	3,500	1,770	1,730
Lend-lease "pipeline" credits	1,500	1,250	(a)
Surplus property credits	1,150	900	250
Ship sales credits	210	110	100
Loan to United Kingdom	3,750	2,050	1,700
Monetary stabilization credits	287	9(b)	278
International Institutional Lending			
International Bank	3,266(c)	100	3,166
International Fund	3,500(d)	58	3,442
U.S. Gov. Relief and Special Aid			
U.N.R.R.A.	2,700(e)	2,700	—
Post-U.N.R.R.A. relief	350	—	350
Relief in occupied areas	1,645	1,000(e)	645(f)
Greek-Turkish aid	400	—	400
Philippine aid program	695	170(g)	525
Internat'l Refugee Organization	74	—	74
Grand Total	23,027	10,117	12,660

(a) Shipments held up, balance not likely to be utilized; (b) As of March 31, 1947; (c) The U. S. capital subscription of $3,175 million plus dollars paid in by other countries through March 31, 1947. The authorized lending power of the Bank is $8 billion; (d) The U. S. quota contribution of $2,750 million plus gold paid in by other countries, partly estimated; (e) Estimated approximate cost; (f) Estimated expenditures in the President's budget for the fiscal year ending June 30, 1948; (g) $100 million made available in surplus materials.

Sources: Assembled from miscellaneous sources including Export-Import Bank reports, Daily Statement of the U. S. Treasury, Treasury Bulletin, Survey of Current Business, reports of the International Bank, Budget for the fiscal year ending June 30, 1948, etc.

The Distribution of Resources

The staggering magnitude of the funds actually and potentially available still leaves open the question of distribution; the dollars may not be available in the places where they will do the most good. So far as dollars not committed to any specific country are concerned, including the bulk of the resources of the International Bank and Fund, and a part of those of the Export-Import Bank, the distribution is elastic and funds can be channeled to the points where they can be employed most constructively.

At the same time, foreign countries that have more gold and dollars than they need may be induced to lend to "dollar-poor" countries which they consider creditworthy. The recent loans, from Switzerland (which finds itself with too many dollars) to France and Belgium (which had too few), and a reported gold loan from Russia to Poland, are cases in point. Credits to Europe that are being extended by Latin American and British Empire countries and by Sweden provide other means of shifting resources to places where the need is greatest.

Influences of Europe's Own Policies

The formulation of a sound opinion as to the severity of the "dollar crisis" depends not only upon information as to the reserves that are available or will become available to other countries, but on an understanding of the fact that their apparent needs may be greatly affected by their internal policies and decisions on matters over which the United States can have little influence. Obviously, foreign countries would have more dollars if they could produce more goods for export. The view so often expressed abroad that this country is unwilling to import does not stand analysis at a time when many goods are still short here. In this Letter last month we pointed out that our imports are running abnormally small, judged by past relationships, in comparison with our national income and with the level of activity and buying power in this country. In other words, if the world produced more to sell to us at attractive prices, we would buy more.

This statement may be countered by saying that Europe needs dollars to buy machinery, raw materials, fuel and food in order to lift production, which is true as far as it goes but fails to deal with all aspects of the question. For a whole group of other questions come up, – the attitude of workers, the hours worked and individual productivity, incentives, the distribution of labor and resources among the industries, and many others.

The inflation that prevails in so many countries itself induces a shortage of dollars; money incomes and home prices have risen so much that prices of American goods look cheap. At the same time the American importer turns away from foreign markets because American consumers will not pay the high foreign price. American travel in foreign countries is discouraged by lack of facilities and high prices.

There can be little hope for balanced trade until some of the disparities in international price levels are corrected. Moreover, a persistent drain of gold and foreign exchange reserves is one of the storm signals that warn of need for correction. Inflation tends to drive money out of a country and to deter nationals from bringing home money that they have outside. Controls are in operation, intended to prevent the escape of capital, but inflationary tendencies strengthen the inducements to evade them, and the controls themselves repel the investor.

Conclusion

It is of interest to observe that Secretary Marshall's diagnosis of Europe's economic needs confirms the findings of a group of business leaders as expressed in a resolution adopted at the meeting of the International Chamber of Commerce in Montreux, Switzerland, last month. This resolution, on monetary problems, reiterates the basic principle that "however urgent the need, foreign lending should be done as part of a constructive scheme holding out the hope of real economic recovery on the basis of a financial stabilization." The resolution says:

> Thus, the most important thing is to get to grips with the problems of monetary and financial reconstruction in order to provide the basis for price stability, more production and better living conditions. As the individual nations formulate realistic programs for their reconstruction it will be possible on the basis of these programs to determine the justifiable needs for foreign loans and credits, the extent to which they can be met by existing agencies and the extent to which supplementary measures may be required.

The resolution goes on to point out how, once the credit position of a country is restored, some of the need for foreign aid will tend to evaporate (1) as hoarded gold and foreign exchange is brought out of hiding for productive investment; (2) as a safe basis is provided for an expansion of foreign commercial credits; and (3) as direct investments by foreign firms are encouraged. These expectations tally with the experience, time after time, of past financial stabilizations.

One most wholesome thing can come out of the talk of a "dollar crisis." The attention given to the exhaustion of American loans and aid focuses attention on the fundamentals, just as did Secretary Marshall's statement. This favorable trend would be dealt a severe blow by any scheme which seemed to offer Europe American loans with no strings attached as a substitute for work and enterprise. The disservice to the incentives to production and the restoration of financial and economic solvency abroad would be no less serious than to our own strength and economic stability.

The test of a successful program of assistance will be the rapidity with which the need for assistance diminishes. The merit of Secretary Marshall's policy is not only that it would carefully study the need and practicability of aid, but that it would make priming the cylinders conditional on the establishment of a program by Europeans to keep the engine running.

A Bill to Regulate Mergers

In our June issue we referred briefly, under the heading "'Swallowing Up' Small Business," to a report by the Federal Trade Commission on the acquisition of more than 1,800 companies by larger companies since the year 1940, and to the Commission's efforts to obtain from Congress

legislation extending its authority over mergers. At that time we called attention to the Commission's preoccupation with the "monopoly" motive as the alleged reason why companies want to buy up smaller companies, and to its failure to deal adequately with the reasons why smaller companies want to sell out.

On June 5 the House Judiciary Committee voted to report out a bill advocated by the Federal Trade Commission to give the Commission authority to check monopoly by regulating mergers accomplished through the purchase of assets of one corporation by another. This is the Kefauver bill (HR 3736). A Senate Judiciary Sub-Committee is holding hearings on a somewhat more drastic bill (S 104) introduced by Senator O'Mahoney of Wyoming. The Kefauver bill in its present form would provide:

> That no corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital, and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly.

Other sections of the bill, which runs to considerable length, provide for enforcement by the Federal Trade Commission and the Courts through hearings, findings, complaints, judgments, decrees, appeals and other proceedings, as well as for jurisdiction in certain special fields by other government departments.

As a follow-up to our discussion last month a comment on this bill seems in order. There are several pertinent tests to apply to the proposed legislation. Is it necessary or desirable in the public interest? Would it lay any substantial burden on business and government, and if so would it be worth the cost? Is the argument for it based on correct presumptions?

Are Anti-Trust Laws Adequate?

Purchase of capital stock by a competing corporation is already prohibited under the Clayton Act of 1914. The Federal Trade Commission contends that this law is not adequate to check the growth of monopoly, and that the failure of the law to restrict any and all purchases of assets of one corporation by another affords a "loophole" permitting monopolies to be formed in spite of the anti-trust laws.

However, the U. S. Attorney General possesses full authority under the Clayton Act and the Sherman Act of 1890 to proceed against monopolies or restraints of trade, regardless of how formed. The existing legal machinery can not only force a stop to illegal mergers, but can bring about the dissolution of any company judged to have monopoly powers. It has been decided by the Supreme Court that injunction or dissolution may be ordered and criminal penalties imposed, even though the concentration has not actually exercised its power to raise prices or exclude competition.

Would Regulation Be Burdensome?

The question whether regulation by the Federal Trade Commission of mergers arising from sale of assets would be burdensome may be judged both by the uncertainty as to how the ambiguous terms of the proposed law might be interpreted, and by the widespread scope of business transfers to which it might apply.

The bill would prohibit all mergers where "in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly." This criterion would have to be applied to specific cases in literally thousands of different industries and their diverse branches. Even the definition of a particular "industry", and obtaining the operating details that would be necessary as to the companies engaged, in many cases would be impossible. This is because industrial classifications are seldom clearcut, companies and products overlap, related and substitute products also affect competition, and the situation continually changes.

Moreover, the term "commerce" has been stretched during recent years in court cases involving labor disputes to include almost every form of gainful activity, while "any section of the country" might take in anything from a few city blocks to a regional group of states. Whether or not competition might be lessened "substantially" is a question that can be guaranteed to keep many lawyers and their fact-finders busy indefinitely. In a recent radio debate on the bill, one of the critics (a lawyer) suggested that it should be entitled, "An Act to prevent unemployment among lawyers."

In the year 1945, the number of businesses sold (exclusive of discontinued businesses) was estimated by the Department of Commerce at 346,000, an average of more than 1,000 for every business day, and represented one out of every nine units in operation at the beginning of that year. A substantial portion of such sales might be judged illegal under the proposed law as tending to lessen competition, unless proof to the contrary could be made before the Federal Trade Commission. The possibilities of litigation, delay and expense would be endless.

The result of delays and uncertainties affecting the sale of one company to another, however compelling the reason for the selling, might well be to make the sale impossible, since the principal market for a small company is generally to be found among other companies in the same or allied lines. At best, the market value of small businesses offered for sale would be affected. At worst, the consequences of so restricting the market might be to compel liquidation with workers thrown out of employment. Thus the prohibition is not only an infringement on the personal liberties of the seller, but its effect would be to put small business at a further disadvantage. Clearly a law whose object is to restrain the growth of monopoly should seek to preserve vigorous and healthy small businesses, and not block their opportunities for expansion by joining with other concerns as well as growth from within.

An unhappy incidental effect of the new proposal, probably not realized by its sponsors, might be to fortify the position now held by the large companies, by making it difficult if not impossible for medium-size and small companies to merge into units that would make them more formidable competitors to the leaders.

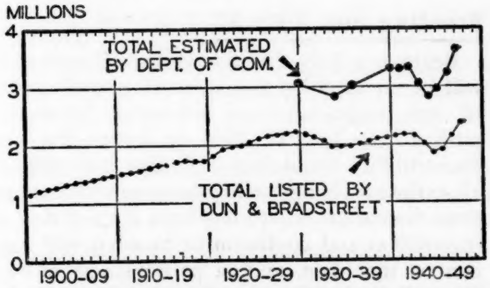
Enactment of the bill would involve also – a matter about which little has been said – a great expansion in personnel and expenditures of the Federal Trade Commission.

Is Monopoly Shown?

The fact that since 1940 there were 1,800 mergers reported by the Federal Trade Commission, plus many times as many that were not reported, is in itself no proof that monopoly is being promoted. In our article last month it was pointed out that mergers are motivated by many considerations other than that of gaining a monopoly.

Small business enterprises having limited manpower and financial resources have always faced special problems and risks, and these have increased with the rising burden of taxes and the growing multiplicity of laws and regulations. Present income taxes absorb such a large share of current earnings that little is left for financing growth and expansion, while the payment of inheritance taxes upon the death of the principal owner may force the liquidation or sale of a business. The constant turnover in the business population, with an average of about one-fifth of the total number of active concerns withdrawing each year, represents chiefly the sales of businesses to other persons or corporations, which far outnumber the failures and forced liquidations. As the withdrawals are usually more than offset by new firms started and by new ownership, the total number of business enterprises normally tends to increase.

This is shown by the accompanying chart picturing the long-term upward trend, averaging 1½ per cent annually over nearly fifty years, in the number of enterprises listed by Dun & Bradstreet in their commercial credit rating books. The chart also includes Department of Commerce estimates for more recent years of the total number of businesses in the U. S., which show that the wartime decrease, caused by shortages of labor and materials, and by proprietors entering the armed services or shifting to war industries, has been more than made up. On December 31, 1946 the total reached 3,644,600, a new high, comparing with 3,307,400 in 1939 and 3,060,000 in 1929.



Total Number of Business Enterprises in the U. S. as Estimated by Department of Commerce, and Total Number Listed by Dun & Bradstreet.

The fact that mergers of large concerns are widely publicized tends to create an impression that business is being concentrated in fewer and fewer hands. The establishment of new firms attracts comparatively little attention.

An Example of "Concentration"

The automobile industry is often cited as an example of "concentration" because of the fact that the three largest companies, plus a dozen or so smaller though very sizable companies, account for almost the entire output of the industry. The large companies, however, do not follow a "monopoly" practice of charging "all that the traffic will bear." On the contrary, current markets show that buyers will pay hundreds of dollars more for cars than the companies are asking, for sales of post-war cars are being made all over the country at such premiums.

The vital question is whether or not the general public is best served in an industry requiring such heavy capital investment by having relatively few large and efficient producers, rather than large numbers of small companies unable to furnish low cost mass production and distribu-

tion. The nature of the industry, and of the production process, is the controlling factor.

In the highly-specialized organization of our economic system there is a place for companies of all sizes. We need now, as during the war, the large organizations using heavy investment in plant and equipment in order to achieve mass-production at low cost while paying high wage rates. But we need also the progressive and efficient medium-sized companies in practically every field, and the smaller companies throughout the service, distribution, and other lines where personal attention, low overhead, and flexibility give them marked advantages over large competitors. These small businesses would be benefited by fewer, rather than more, government restrictions and regulations of their freedom of movement.

Sterling and July 15

Beginning July 15, the British Government will be under obligation, according to the terms of the Anglo-American Financial Agreement ratified here July 15, 1946, to restore the free convertibility into dollars and other currencies of all sterling exchange arising from current transactions thereafter. There has been a good deal of speculation and confusion as to what will happen on that date, and in particular as to how Great Britain will meet the complex and difficult problems involved in assuming such an obligation while she owes so much to other countries and while her balance of payments is so unfavorable.

The definition of a "current transaction" in the Agreement is the same as given in the Articles of Agreement of the International Monetary Fund, Art. 19, section (1):

> Payments for current transactions means payments which are not for the purpose of transferring capital, and include, without limitation:
>
> (1) All payments due in connection with foreign trade, other current business, including services, and normal short-term banking and credit facilities; (2) Payments due as interest on loans and as net income from other investments; (3) Payments of moderate amount for amortization of loans or for depreciation of direct investments; (4) Moderate remittances for family living expenses.

July 15 is, therefore, an important milestone on the road to restoration of multilateral trade and free convertibility of all currencies. To expect, however, that convertibility of current sterling will result in a great and sudden increase in the dollars available to Britain's suppliers and creditors, with corresponding effect on our export prospects, would be unwarranted by the facts. It s more likely that the date will pass without much notice by the average trader.

Segregation of Old and New Sterling

One reason for this is that the British have already made progress toward meeting this obligation. They have approached convertibility step by step, starting with the countries where the problems involved were the most manageable. In each case, the main problem was to work out arrangements whereby current sterling could be segregated from the old inconvertible balances, which total more than £3.5 billion. The objective was to prevent the old sterling from being used for payment for current purchases in Great Britain and in general to limit its use even within the sterling area. Otherwise, countries would be likely to use old sterling to buy with, and to convert the new sterling into hard currencies. Hence the British would have been faced with the problem of converting all the sterling arising from current transactions, rather than the net balance only.

The necessity for such arrangements is obvious. During the first quarter of this year, Britain's imports from countries other than the United States and Canada were at the annual rate of about £1 billion. If the whole amount were to be converted into hard currencies, British resources, including unspent credits in this country and Canada, would quickly be dissipated. On the other hand, the conversion of net balances with each country, over and above those which are already being converted or which in the main will be allowed to accumulate in sterling, will entail a comparatively small additional drain on Britain's dollars. According to the London Economist: "If the promise of convertibility costs Britain as much as £50 million ($200 million) in hard currencies this year, we shall have to deem ourselves very unfortunate."

The British would have preferred to have more time to work out arrangements for the segregation of old and new sterling. Almost every country presents a different problem, either because of the circumstances that led to the accumulation of inconvertible sterling or because of distribution of the balances. In Eire, for example, accumulated old sterling is apparently so widely dispersed as to rule out any hard and fast arrangement with the authorities.

Transferable and American Accounts

However, much progress has already been made. The first group of countries among which currently earned sterling became freely transferable included the United States, Venezuela,

Mexico, and the seven Central American and Caribbean Republics. None of these countries, known as "American accounts" since early in the war, had large accumulations of old sterling.

Early this year the privilege of transferability of current sterling to American accounts was extended to Canadian, Newfoundland and Argentine accounts. Also, a system of so-called "transferable accounts" was established for Dutch, Belgian and Portuguese monetary areas. These accounts may be credited with the proceeds of current transactions, and so far as Great Britain is concerned transfers are freely allowed among them as well as to American accounts. They are of course subject to controls that may be exercised by the countries concerned.

Side by side with the new sterling accounts, each of the above countries maintains old sterling accounts. In some cases, the funds in these accounts are now "blocked", in others they are used for special capital transactions, and in still others they can be used for payment in the sterling area, although there is a tendency to limit their uses in this respect. Argentina's old sterling accumulations, reported at about £150 million, are being used in payment for British-owned railways in Argentina.

Since early this year, the area in which sterling currently accruing to residents may be used more freely has been extended to Italy, Vatican City, Spain, and Brazil. Arrangements with France, Uruguay, and the Scandinavian countries are expected to be concluded before long.

Sterling Area Problems

Under the terms of the Agreement the sterling area — defined as a system of cooperative exchange controls operated by an association of separate countries — is to be dissolved. Instead, each sovereign country now belonging to it will have full foreign exchange autonomy. However, some will keep their currencies pegged to sterling. Thus the wartime system known as the sterling area will revert to the prewar arrangement known as the sterling bloc.

In a good many countries of the sterling area, the separation of the old from the new sterling is not expected to require any formal agreement. Australia and New Zealand have already indicated that they will give full cooperation to the British authorities. Presumably the colonial governments will also abide by London's wishes and will not spend accumulated sterling too fast.

The crux of the problem of extending free convertibility to the present sterling area lies in the settlement with India, Egypt, and Eire. Together with Iraq and Iran, these countries held over £2 billion in accumulated sterling out of the total of more than £3.5 billion. Moreover, each of these countries has a good case why some of its accumulated old sterling should be spent for extra imports of industrial goods. In the negotiations which have been carried on with some of the big creditors, such as India and Egypt, Great Britain was asked to convert a part of present balances into dollars immediately and to fund the remainder at an interest rate generally mentioned as 2 per cent. Britain has protested her inability to convert any of the existing balances under present circumstances or to speed up export of industrial goods, and she holds that the interest rate should not exceed ½ per cent.

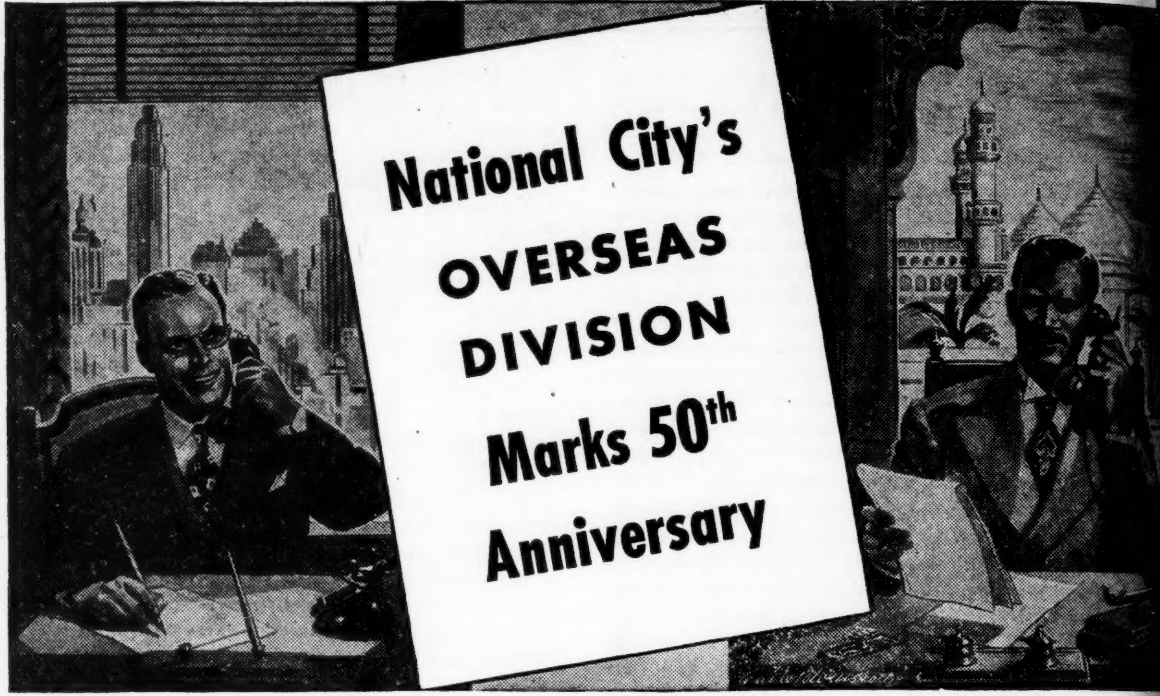
The negotiations with Egypt have apparently produced provisional agreement under which Egypt has agreed not to call for more than a fractional percentage of her £400 million balances, between July 15 and the time when the permanent agreement is concluded. The negotiations with India were postponed but some temporary arrangement prior to July 15 is a possibility. The alternative, as the London Economist suggests, would be unilateral action on the part of London blocking the balances even for use within the sterling area. But there is reason to believe that such action would be taken only as a last resort.

Exchange Control Stays

It may be well to point out that even with current sterling becoming freely convertible on July 15, the British Exchange Control, which is now a permanent fixture, will continue to regulate the movement of capital in and out of the country. Also, Great Britain will continue to regulate her international balance of payments by the control of imports and exports. However, in regard to imports, the Financial Agreement stipulates that there must not be official discrimination against the source of imports.

Also, the fact that the current pound sterling will be convertible does not mean that the currencies of other sterling bloc countries, Australia, New Zealand, Egypt, or for that matter, India, will be freely convertible. The principal change will consist in individual sterling bloc countries deciding, rather than the sterling area pool authorities, how the dollars earned can be used.

In summary, the facts warrant the encouraging conclusion that the July 15 date, about which there has been a good deal of apprehension, is likely to pass without dramatic developments and without serious strain on sterling. But the world will be carried one step nearer toward normal monetary conditions in the conduct of trade.



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